MEMORANDUM

ASSOCIATION OF BAY AREA GOVERNMENTS **Agenda Item #4**

Representing City and County Governments of the San Francisco Bay Area **Attach. A – Page 1**

DATE: October 11, 2001

TO: Natural Gas Program Participants of ABAG POWER

FROM: Gerald L. Lahr, Manager, ABAG POWER

RE: **Staff Report on 2000-2001 Natural Gas Program**

In 2000-2001 the ABAG POWER Natural Gas Program experienced, for the first time in the five-year life of the program, a negative savings in comparison to PG&E. The total program savings for all core gas accounts, including storage credits, averaged -6.2% compared to 11.0% last year. The total dollar savings for all program core gas accounts (including the storage credits) was -$374,345. This resulted in a reduction to the accumulated savings for the natural gas program since its inception in 1996, and it is now approximately $126,759, for an average annual savings of 4% for the five years of the program. The savings will vary among individual program members based upon their seasonal use of natural gas.

PROGRAM ELEMENTS

The total cost for the natural gas program for 2000-2001 increased dramatically from $3,387,148 to $9,475,592 reflecting the skyrocketing rise in natural gas prices that occurred during this program year. A review of each major program cost element is summarized as follows:

Transportation and Distribution Costs. A major cost of the natural gas program is the amount charged for the transportation and distribution of natural gas to the customer. Distribution costs are established by a PUC tariff rate and charged by PG&E to all gas customers. Transportation rates vary depending on the path used to deliver the gas onto PG&E's distribution system. In the early years of the program these costs represented approximately 60% of the total program costs. Last year with the increase in gas prices the relative impact of these costs declined to 41%, and this year with the further rise in gas costs the relative effect declined further to 22.5%, even though the total transportation and distribution costs increased from $1.4 to $2.1 million.

Natural Gas Commodity Cost. The natural gas commodity cost increased from $1.9 million to $7.2 million for the 2000-2001 program year. The commodity portion is composed of natural gas purchases from the gas supplier for monthly consumption; required storage, and gas to balance the program's monthly consumption with usage projections. In the past, the natural gas commodity typically represented about a third of the total program cost, however this program year it increased to approximately 76%, reflecting the skyrocketing prices. Also, the programs total gas consumption increased by 22% from 6,369,894 to 7,775,207 therms, reflecting the addition of new program members and differences in the weather.

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During 2000-2001 the program's natural gas supplier, TXU Energy Services, provided natural gas to program members for consumption, storage and balancing. The contract with TXU Energy Services provided for the purchase of natural gas at a fixed price of $.145/Dth less than the National Gas Index (NGI) PG&E Citygate gas price. This market index, which is a common market rate standard for commodity purchases, responds to various market conditions that influence the price of natural gas, and is comparable with the PG&E G-CP rate.

ABAG POWER Program Expenses. The remaining costs of the program are the expenses for billing services, gas program scheduling and administrative support, including financial and legal services. The total cost of these services was $108,853 or about 1.1% for the 2000-2001 program year. TXU Energy Services served as the program's gas scheduler as well as commodity supplier and IQ Solutions was the programs billing agent.

PROGRAM OPERATIONS AND GAS MARKET PRICES

The most significant change in the natural gas program during the 2000-2001 program year was the skyrocketing rise in natural gas prices. Prior to last year natural gas prices normally varied from a low of $2.00/Dth in the summer to the mid-$3.00/Dth range in the winter when demand is higher. In the 1999-2000 program year commodity prices increased from the low $2.00/Dth range to approximately $4.50/Dth (this price occurring during the normally low-priced summer months). In the 2000-2001 program year the commodity price offered to ABAG POWER members increased from $4.56/Dth in July 2000 to a high of $12.30/Dth in May 2001.

The high natural gas prices throughout the West were a significant factor in causing the energy crises that California experienced during the past year. There are many reasons currently being debated at the public policy level on the cause of the significant price increases for natural gas and electricity. These reasons include: the large demand for gas from electrical generators; market power of a few energy companies; limitations and restrictions in gas line capacity, and simple supply and demand. Both the natural gas and electric markets have been very unstable during the past year making reasonable market projections difficult if not impossible. As a further reflection of this the October 2001 PG&E commodity price for natural gas fell to its lowest level in years at $0.998. There is little rational explanation as to why natural gas prices are below $2.00/Dth in October and were almost $13.00/Dth in May of this year.

ABAG POWER like other natural gas core aggregation program providers were also disadvantaged last year by PG&E's ability to secure lower cost gas through its rights on the Canadian ANG and NOVA gas lines. Core aggregation program providers such as ABAG POWER are currently precluded from receiving rights to this favorably priced gas line capacity which resulted in higher cost capacity having to be purchased at the northern and southern California border. Earlier this year, ABAG POWER and the School Project for Utility Rate Reduction (SPURR) filed a joint application with the California Public Utility Commission (CPUC) to enable core aggregation providers to have access to this Canadian Transmission Capacity. A decision on this matter is expected shortly.

In an effort to stabilize natural gas rates to its members the ABAG POWER Executive Board took action to lock in 75% of the programs natural gas load at a fixed rate of $7.63/Dth starting in July 2001 as rates came down in the spring of this year. Although the natural gas market has continued to decline it is hoped the new fixed rate will not only provide improved price stability but also be competitive to PG&E by the end of the current 2001-2002 program year.

SUMMARY

In summary, the natural gas program did not achieve a savings in comparison to PG&E in 2000-2001 due to extremely unstable market conditions and related factors, however the program has still resulted in an average 4% savings during its five years of operation, and resulted in a net dollar savings of approximately $126,759 to its members. We look forward to working with you during the coming year to make this program responsive to the needs of its member agencies.

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